

TEACHERS' RETIREMENT BOARD

INVESTMENT COMMITTEE

SUBJECT: Fixed Income – Securities Lending RFP

ITEM NUMBER: 5

ATTACHMENT(S): 1

ACTION: X

DATE OF MEETING: September 1, 1999

INFORMATION: _____

Ms. Cunningham
PRESENTER(S): Mr. Hosokawa

EXECUTIVE SUMMARY

The California State Teachers' Retirement System (CalSTRS) has developed a Securities Lending Program designed to enable CalSTRS to use its existing asset base and investment expertise to generate additional income. The income generated from any particular loan is dependent upon two factors: 1) the negotiated lending terms agreed upon at the outset of the loan and 2) the return generated from the management of the cash taken as collateral for the loan. CalSTRS manages its Securities Lending Program within the following arrangements, in an attempt to provide an appropriate balance between risk control and diversification:

- Agent Lending/Agent Cash Collateral Management
- Agent Lending/CalSTRS Cash Collateral Management
- Principal Lending/CalSTRS Cash Collateral Management

Under the first arrangement, a portion of the Securities Lending Program is managed on an agent basis in which both the lending terms and the collateral management are the responsibility of an external contractor acting as a fiduciary for CalSTRS. Under the second arrangement, the external contractor negotiates the lending terms, while the cash collateral is managed internally within CalSTRS' Fixed Income Unit. Under the final arrangement, a portion of the program is managed on a principal basis, in which the responsibility for both the lending terms and the collateral management belongs to CalSTRS' Fixed Income unit.

The RFP process for investment managers, consultants, and etc. requires all successful proposers to meet, or demonstrate a good faith effort to meet, contract participation goal requirements of three percent (3%) disabled veteran business enterprises. The percentage is calculated based on the proposed investment fees charged to CalSTRS for providing the services described in the RFP.

The securities lending RFP is unique in that CalSTRS does not compensate the Contractor(s) for services rendered. Rather, the Contractor(s) pay revenues to CalSTRS. This arrangement makes it virtually impossible to calculate percentages for disabled veterans contract participation. Further, the nature of the services to be provided under contract do not lend themselves to subcontracting, as there are no goods and/or services that the Contractors need to acquire in order to fulfill their contractual obligations to

CalSTRS.

As a result, staff is proposing that this RFP and any resultant contract(s) be exempted from contract participation goal requirements. In the absence of contract participation goal requirements, staff is proposing to include the following language in the RFP:

The Teachers' Retirement Board has adopted a policy that directs staff to encourage, prompt, and facilitate the fullest possible participation by disabled veteran business enterprises in contracts awarded by CalSTRS. In accordance with this policy, CalSTRS encourages its contractors to seek opportunities, whenever possible, to do business with disabled veteran owned firms.

One of the 1999/00 objectives approved for the Investment Branch is to prepare, release, and evaluate a Request for Proposal (RFP) for securities lending agents. The current contracts are scheduled to expire on January 31, 2000.

Attachment 1 represents the proposed specifications for the CalSTRS Assets – Securities Lending RFP, which include:

- Time line for the RFP
- Introduction
- Purpose of the RFP
- Services to be Provided
- Minimum Qualifications
- Fee Structure
- Proposal Evaluation Criteria

RECOMMENDATION

In concert with the previous RFPs (paralleling the process for the domestic and international equity manager searches), staff recommends that the Investment Committee approve the following:

1. Extensions of current contracts, as needed, to accommodate the timeline for the RFP process.
2. Release of the Request for Proposal as described in Attachment 1;
3. Use of an "Agent Pool" of qualified agents to replace terminated agents or to supplement the roster of contracted agents;
4. Use of open ended contracts (Evergreen contracts),
5. Waiver of disabled veteran contract participation goal requirements, and;
6. Delegation of the "Final Selection" to staff and PCA with periodic updates to the Investment Committee.

CALIFORNIA STATE TEACHERS' RETIREMENT SYSTEM
REQUEST FOR PROPOSAL

CalSTRS ASSETS - SECURITIES LENDING

TIME SCHEDULE:

1. Date of Issue:	<u>October 1999</u>
2. Deadline for Submission of Written Questions:	<u>October 1999</u>
3. Final Filing Date:	<u>November 1999</u>
4. Pre-Evaluation Screening:	<u>November 1999</u>
5. Proposal Evaluation:	<u>November 1999</u>
6. Interviews:	<u>TBA</u>
7. Reference Checks:	<u>TBA</u>
8. On-Site (Optional):	<u>TBA</u>
9. Post Notice of Intent to Award:	<u>Immediately after selection</u>
10. Award of Contract:	<u>5 business days after posting Notice of Intent to Award</u>

CALIFORNIA STATE TEACHERS' RETIREMENT SYSTEM REQUEST FOR PROPOSAL

CalSTRS ASSETS - SECURITIES LENDING

I. INTRODUCTION

The California State Teachers' Retirement System (CalSTRS) administers an investment portfolio with approximately \$100 billion in total assets. As of June 30, 1999, the assets were invested as follows: \$45.9 billion in domestic equities; \$23.7 billion in international equities, \$24.9 billion in domestic fixed income securities; \$2.2 billion in real estate equity; \$2.6 billion in alternative investments and \$0.7 billion in cash reserves. The Investment Management Plan adopted by the Teachers' Retirement Board (Board) provides an investment structure designed to provide diversification within each component of the portfolio. The domestic and international equity structure contains both passive and active components.

Over the past ten years, CalSTRS has developed a Securities Lending Program designed to enable the System to use its existing asset base and investment expertise to generate additional income. The CalSTRS Securities Lending Program is managed based upon the two determinants of securities lending income: 1) the negotiated lending terms agreed upon at the outset of the loan and 2) the return generated from the management of the cash taken as collateral for the loan. CalSTRS is in the process of soliciting proposals from firms with expertise in both the lending and cash collateral management activities associated with the securities lending of CalSTRS' assets (such as domestic and international equities and fixed income securities).

CalSTRS intends to award contracts to a maximum of ten (10) firms within the categories identified in Section III (A). CalSTRS reserves the right to determine the number of contracts which will be awarded, as well as the amount of securities which will be made available to each Contractor. In the event that none of the proposals are satisfactory, then no selection will be made in that category. Prospective contractors may submit proposals for each of the investment categories (domestic equity, international equity, domestic fixed income, and international fixed income). If more than one category is proposed, each category must be clearly identified in the proposal.

CalSTRS will also establish a "pool" of qualified agents from this process. This pool would be used to replace agents that might be terminated in the future or to add an agent(s) as necessary. Contracts will be executed prior to the distribution of assets to be lent.

II. PURPOSE

Pursuant to Education Code 22203, CalSTRS is seeking qualified firms to act as fiduciaries of the System and to provide securities lending services for the lendable assets within its investment portfolios. CalSTRS defines lendable assets as those securities that

have an established market or demand by borrowers, such as domestic and international equity. A more complete description of the types of lendable assets included under this RFP can be found in Section III (A).

III. SERVICES TO BE PROVIDED

Please note that the Contractor(s) may provide either "A" or "A and B" of the services described below:

- A. The contractor will negotiate the lending terms for CalSTRS' investment assets within the following asset categories: **(This portion of the services is mandatory. CalSTRS requires each Proposer to bid on the lending of any combination, or all, of the identified asset categories.)**

Domestic Equity

International Equity

Domestic Fixed Income

International Fixed Income

- B. The contractor may provide management of the cash received as collateral for the lending activity. **(This portion of the services is optional. CalSTRS does not require the Proposer to bid on the cash management portion of the RFP and reserves the right to assume and/or assign the responsibility of the management of the cash collateral at its discretion.)**
- C. The contractor will provide advice to CalSTRS' staff and Board on market conditions, including positive and negative trends, and various security related issues.
- D. The contractor will provide reports to CalSTRS' staff, Board and consultants as required by CalSTRS.
- E. The contractor will attend Investment Committee, Board and/or staff meetings in California as requested by CalSTRS.

IV. MINIMUM QUALIFICATIONS

The Proposer must meet all of the following minimum qualifications to be given further consideration for a contract award. Failure to satisfy all of the minimum qualifications, based on CalSTRS' sole judgement, may result in the immediate rejection of the proposal.

1. The Proposer must be a National Association of Securities Dealers member firm, primary reporting dealer, or FDIC insured bank.

2. The Proposer must have an average daily balance of securities loaned or borrowed of more than \$1 billion.
3. The organization's key professionals must have at least five (5) years of securities lending experience.
4. The Proposer must have at least three clients, one of which must be a public fund customer, participating in its securities lending program.

CALIFORNIA STATE TEACHERS' RETIREMENT SYSTEM
REQUEST FOR PROPOSAL

CalSTRS ASSETS - SECURITIES LENDING

FEE PROPOSAL

Name of Proposer

Proposers must submit their fee proposal in the format prescribed below. Any deviation from the prescribed format which, in the opinion of CalSTRS, is material, may result in the rejection of the proposal. The proposed fee split shall include all costs for providing the securities lending services to CalSTRS, as described in this RFP. Once the Contractor is selected, the fee split may be further refined, depending on factors, which may affect the proposed fee split. In no case will CalSTRS' portion of the refined fee split be lower than that contained in the fee proposal.

As described in Section III, Paragraph A, CalSTRS is requiring each Proposer to bid on the lending of any one, combination, or all, of the selected asset categories. **For purposes of this fee proposal, each asset category will be scored separately.**

CalSTRS is also allowing, at the discretion of the Proposer, a bid on cash collateral management as described in Section III, Paragraph B. This portion is optional and will not be scored. CalSTRS reserves the right to assume and/or assign the responsibility of the management of the cash collateral at its discretion.

A. SECURITIES LENDING

CalSTRS recognizes that the income generated from securities lending is derived from two sources: 1) the negotiated lending terms agreed upon at the outset of the loan and 2) the returns generated from the management of cash collateral. Therefore, in order to be able to evaluate the value added from each area, please complete the following schedule for any one, combination or all of the asset categories. IT IS MANDATORY THAT THIS PORTION BE COMPLETED:

I have interest in lending CalSTRS' securities for the following asset category(ies):		Proposed fee split to CalSTRS
Domestic Equity		%
Domestic Fixed Income		%
International Equity		%
International Fixed Income		%

B. CASH MANAGEMENT

Should you have interest in managing the cash collateral within the guidelines to be provided by CalSTRS, please provide your collateral management fee in basis points. THIS PORTION IS OPTIONAL:

Cash Management Fee _____ basis points

Proposer's Authorized Signature

Title

Date

CALIFORNIA STATE TEACHERS' RETIREMENT SYSTEM
REQUEST FOR PROPOSAL

CalSTRS ASSETS - SECURITIES LENDING

PROPOSAL EVALUATION FORM

Name of Proposer

	<u>MAXIMUM POINT SCORE</u>	<u>PROPOSER'S POINT SCORE</u>
A. PROPOSAL QUESTIONNAIRE		
<u>Sec. I - Organizational Background</u> Financial Position, Experience/Depth of Staff, Borrower Indemnification	<u>25</u>	_____
<u>Sec. II - Lending Operation</u> Number of Clients, Lendable Asset Base, Loan Apportionment, Agent Advantages	<u>30</u>	_____
<u>Sec. III - Borrower Selection/Credit Analysis</u> Borrower Approval Process, Risk Management Process	<u>15</u>	_____
<u>Section IV - Reporting/Technology</u> Reporting Flexibility, On-line Capability	<u>10</u>	_____
Total Item A*	<u>80</u>	_____
B. FEE PROPOSAL	<u>65</u>	_____
C. SEMI-FINALIST** (if required)	<u>Pass/Fail</u>	_____
D. FINALIST INTERVIEW	<u>105</u>	_____
GRAND TOTAL	<u>250</u>	_____

* A Proposer must receive a minimum score of at least 56 points on the Proposal Questionnaire to be given further consideration.

** A Proposer must receive a PASS rating on the Semi-Finalist Interview to be given further consideration.

Evaluator Number _____

Date _____

PROPOSED
RESOLUTION
OF THE
TEACHERS' RETIREMENT BOARD
INVESTMENT COMMITTEE

Subject: Request for Proposal for CalSTRS Assets Securities Lending

Resolution No. _____

WHEREAS, the Board is responsible for managing the Teachers' Retirement Fund (Fund), a Pension Fund; and

WHEREAS, the Board desires to contract with qualified firm(s) with expertise in securities lending to act as fiduciaries of the System and to provide securities lending services for the lendable assets within its investment portfolios; and

WHEREAS, the Committee has reviewed the written material and oral presentation from staff; Therefore be it

RESOLVED, that the Committee hereby approves the following:

1. Extension of current contracts, as needed, to accommodate the timeline for the RFP process.
2. Release of the Request for Proposal as described in Attachment 1;
3. Use of an "Agent Pool" of qualified active agents to replace terminated agents or to supplement the roster of contracted agents;
4. Use of opened ended contracts (Evergreen contracts);
5. Waiver of disabled veteran contract participation goal requirements, and;
6. Delegation of the "Final Selection" to staff and PCA with periodic updates to the Investment Committee.

Adopted by:

Investment Committee
on September 1, 1999

James D. Mosman
Chief Executive Officer